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RUEHLH/AMCONSUL LAHORE PRIORITY 2653  
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C O N F I D E N T I A L SECTION 01 OF 03 KARACHI 000053

SIPDIS

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TAGS: [ENRG](#) [EFIN](#) [EINV](#) [PK](#)

SUBJECT: SINDH - UNRESOLVED DEBT ISSUE COULD SHORT-CIRCUIT  
KARACHI ELECTRIC DEAL

REF: A. KARACHI 21

- [1](#)B. 08 KARACHI 508
- [1](#)C. 08 KARACHI 587
- [1](#)D. 08 KARACHI 533
- [1](#)E. 08 KARACHI 199
- [1](#)F. 08 KARACHI 420
- [1](#)G. 08 KARACHI 600
- [1](#)H. KARACHI 32

Classified By: Classified by Consul General Stephen G. Fakan for reasons 1.4(b) and (d).

[1](#)1. (C) Summary: In a January 27 meeting Karachi Electrical Supply Company (KESC) Managing Director Naveed Ismail told the CG that the Dubai-based Abrajj Group may not finalize the purchase of KESC unless the Government of Pakistan (GOP) assumes a debt that could run as high as \$1.06 billion to the federally owned Water and Power Development Authority (WAPDA). WAPDA provides KESC power on an as-needed basis, but there is a major disagreement on price. Although KESC receives widespread criticism, Ismail is confident that he can turn the firm into a profitable corporation, and has taken such bold steps as slashing 10,000 jobs and turning off power at government agencies which haven't paid their bills. Until the WAPDA debt impasse and the larger "circular debt" issue are resolved, however, the possibility of Abrajj's handing KESC back to the cash-strapped GOP remains. End summary.

The WAPDA Debt: A Deal Breaker  
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[1](#)2. (SBU) The Karachi Electric Supply Company (KESC) announced that Dubai-based Al Abrajj Capital, a consortium of private investors and sovereign wealth funds, would take over the company in July 2008 (ref F), but Abrajj did not assume operation of KESC until September 2008. At the time, KESC owed \$620 million to the federally owned Water and Power Development Authority (WAPDA), which supplies electricity to KESC.

[1](#)3. (SBU) WAPDA, for its part, claims KESC may owe it as much as \$1.06 billion. The discrepancy arose over how the electricity was priced. Abrajj can still cancel the KESC purchase if an agreement is not reached on this issue. Ismail told the CG he wants the deal to work if at all possible, but his company is prepared to walk away from KESC if this is not fixed. Ismail emphasized that Abrajj does not have a set deadline to resolve the issue, but they are insistent that the GOP assume the entire debt, the amount of

which has not yet been agreed upon.

#### Circular Debt an Impediment

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¶4. (SBU) KESC's debt to WAPDA is part of a larger "circular debt" issue plaguing Pakistan's energy industry, which has its genesis in GOP subsidies. Power plants acquire fuel from distributors at a GOP-controlled price, which may not reflect the actual market cost. Since consumers are not paying full market rates for power, billing receipts are not sufficient to cover the electricity provider's actual fuel costs.

¶5. (SBU) WAPDA, which supplies or supplements many of the electricity providers, is not collecting enough revenue to pay power generation expenses. GOP subsidies intended to cover the difference are often delayed, making payments to fuel providers chronically late. As a result, the GOP has pressured many fuel providers to accept longer billing cycles or to cut prices, which impacts their ability to fund necessary imports.

#### Frustrating Missed Opportunities

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¶6. (C) Ismail is frustrated by the fact that KESC nearly reached a deal with the GOP on the WAPDA debt under the previous Musharraf administration. The current government became reluctant to take on the WAPDA debt once it decided to accept IMF assistance, however, according to Ismael. Abrajj has already provided a USD 42 million loan to KESC and the

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GOP retains a 25 percent stake in the company.

#### No Winners if Deal Fails

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¶7. (C) Both Abrajj and the GOP stand to lose if the deal falls through. More disturbing is the possibility that the GOP may end up operating KESC again, after first privatizing the company in 2004. (Comment: Rashid Rabani, Advisor to the Chief Minister of Sindh, told Econ Officer on February 4 that his party, the Pakistan Peoples Party (PPP), wants to re-nationalize KESC. However, he was not sure if the PPP could get a mandate to do so. Federal Minister for Privatization Naveed Qamar ruled out any possibility of reversing the privatization of KESC in an interview with the Business Recorder on February 7. End comment.)

#### Unfulfilled \$350 Million Pledge

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¶8. (SBU) After Abrajj took control, Ismail became KESC's Managing Director and Abrajj pledged to invest USD 350 million to upgrade the company's power generation and distribution system. (Comment: Since the average age of KESC's generators is 27 years old and 99 percent of their electricity comes from burning oil, an upgrade of KESC equipment is much needed. End comment.) Abrajj has not yet made the promised investment and some observers think the company may back out of its agreement to purchase KESC instead of making the \$350 million investment (ref A).

¶9. (C) Ismail revealed that in addition to its stated pledge to invest \$350 million, Abrajj may invest another \$450 million and seek total capital investment in KESC of around \$4-\$5 billion. He also said that he doesn't have confidence in KESC's in-house audit staff and uses Price Waterhouse Cooper (PWC) to conduct audits.

#### Abrajj Makes Improvements, Has Plans

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¶10. (C) Ismail told Islamabad Commercial Counselor on

February 4 that, since September, he has slashed 10,000 positions from KESC's payroll and turned off the power at more than one GOP agency for non-payment, including an Army installation. Abrajj plans to hire consultants from McKinsey and Company and is considering filing suit against former KESC operator Siemens for non-performance. (Comment: Ismail believes Siemens made unnecessary purchases of their own equipment while running KESC. End comment.)

Wanted: Energy Policy

11. (SBU) Ismail sees a path forward for KESC but believes it will be painful. He sees modernization of KESC's plants and switching from oil to gas or coal generators as the key to the company's future. Raising electric rates or taxes will be difficult for the GOP. Ismail also has a long list of operational problems that must be fixed. Widespread theft of electricity is common, as are dishonest meter readers and customers who simply refuse to pay their bills, reducing KESC's expected monthly collections from \$94 million to \$80 million. Ismail hoped energy conservation measures could help lessen demand, but noted that the coming summer months will bring peak demand for electricity.

Comment

12. (SBU) Ismail, whose comments to the CG mirror those he made during a February 4 meeting with Islamabad Commercial Counselor, has nearly forty years experience in the utility business and has built a career out of repairing troubled power companies throughout the world. In Pakistan, he previously served as country director for AES Corporation, one of the largest independent power producers in the country. A proponent of developing Thar coal to meet the country's energy needs (ref H), Ismail is an advisor and close confidant of Dr. Asim Hussain who heads the Ministry of

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Petroleum and Natural Resources.

13. (SBU) Ismail faces a sizable challenge but isn't shrinking from it. He proudly mentions operational improvements such as the addition of 120 megawatts to KESC's generation since his arrival. Ismail has proposed adding a few cents to each customer's monthly bill to amortize the WAPDA debt over a period of years, an idea the GOP has yet to embrace. The withdrawal of Abrajj Capital could force the GOP to step in and take on financial obligations it can ill afford.

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